

UT 99-2

Tax Type: Use Tax

Issue: Use Tax on Leased Items

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

“DR. DANIEL DEFOE”,

Taxpayer

No. 97-ST-0000

IBT: 0000-0000

Christine O’Donoghue
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Charles Hickman, Special Assistant Attorney General for the Illinois Department of Revenue; Mr. James W. Morris, Esq. for “Daniel Defoe”.

Synopsis:

The matter comes on for hearing pursuant to the “Daniel DeFoe’s” (hereinafter “taxpayer” or “DeFoe”) protest of the Notices of Tax Liability issued for the audit period of 7/1/90 through 12/31/95. The taxpayer argues that the Department assessed Use Tax, penalty and interest against the wrong entity while the Department maintains that the documents in evidence prove that taxpayer purchased the equipment at issue for use in Illinois and, therefore, is subject to the Use Tax Act and any subsequent transfers by taxpayer to various trusts does not discharge the taxpayer of his tax liability. A hearing

was held on June 30, 1998 in Springfield and post-hearing briefs were filed.¹ Following the submission of all evidence and a review of the record and briefs filed herein, it is my determination that the Notices of Tax Liability should be finalized.

Findings of Fact:

1. The Department established its *prima facie* case by the admission of the SC-10, Audit Correction and/or Determination of Tax Due for the audit period of 7/1/90 through 12/31/95. Dept. Ex. No. 1.
2. An audit was conducted on the professional corporation that operates Dr. DeFoe's medical practice, "Clear Vision Eye Center, Inc." Tr. p. 8. During the audit of the professional corporation, the auditor noted certain leases with "Dr. DeFoe", individually. Tr. p. 8. An audit of "Dr. DeFoe" was ordered to determine if use tax had been paid on the leased equipment. Tr. p. 8.
3. The auditor requested that the taxpayer produce checks of \$1,000.00 or more and the corresponding purchase invoices. Tr. p. 10.
4. Some invoices were for items purchased from out-of-state vendors who directly shipped the equipment to the taxpayer in Illinois. Tr. p. 11. The auditor assessed Illinois Use Tax on these purchases. Tr. p. 11.
5. The auditor assessed the difference between the Illinois' Use Tax rate and the second state's tax rate on items purchased and picked up outside the state and subsequently brought into Illinois. Tr. p. 12.

¹ The Administrative Law Judge who presided at the hearing is on administrative leave. Since no issues of credibility need be determined, this case has been assigned to me to thoroughly review the record and issue a Recommendation for Disposition.

6. The taxpayer's CPA produced various lease agreements for the auditor's examination. The auditor reviewed approximately 43 lease agreements during the audit of the taxpayer. Tr. p. 15.
7. "Dr. Daniel DeFoe" purchased equipment which was eventually transferred to "John Doe", as Trust Custodian and was the subject of Equipment Lease Agreement No: 22A between "John Doe", as Custodian for "Harold DeFoe", Under the Illinois Uniform Transfer to Minors Act as lessor, and "Clear Vision Eye Center, Inc.", as lessee. *See*, Taxpayer Ex. No. 1, Check no. 1.
8. "Dr. Daniel DeFoe" purchased equipment which was eventually transferred to "John Doe", as Trust Custodian and was the subject of Equipment Lease Agreement No: 23A between "John Doe", as Custodian for "Hakeem DeFoe" Under the Illinois Uniform Transfer to Minors Act as lessor, and "Clear Vision Eye Center, Inc.", as lessee. *See*, Taxpayer Ex. No. 2, Check no. 1.
9. "Dr. Daniel DeFoe" purchased equipment which was eventually transferred to "John Doe", as Trust Custodian and was the subject of Equipment Lease Agreement No: 24A between "John Doe", as Custodian for "Rolando DeFoe" Under the Illinois Uniform Transfer to Minors Act as lessor, and "Clear Vision Eye Center, Inc.", as lessee. *See*, Taxpayer Ex. No. 3, p. 1.
10. "Dr. Daniel DeFoe" purchased equipment which was eventually transferred to "John Doe", as Trust Custodian and was the subject of Equipment Lease Agreement No: 25A between "John Doe", as Custodian for "Fatima DeFoe" Under the Illinois Uniform transfer to Minors Act as lessor, and "Clear Vision Eye Center, Inc.", as lessee. *See*, Taxpayer Ex. No. 4, check no. 1.

11. “Dr. Daniel DeFoe” purchased the equipment which was the subject of Equipment Lease Agreement No: 34A between “John Doe”, as Custodian for “Foushad DeFoe” Under the Illinois Uniform Transfer to Minors Act as lessor, and “Clear Vision Eye Center, Inc.”, as lessee. *See*, Taxpayer Ex. No. 5. Check no. 2485.
12. “Dr. Daniel DeFoe” purchased the equipment which was the subject of Equipment Lease Agreement No: 35A between “John Doe”, as Custodian for “Foushad DeFoe”, Under the Illinois Uniform Transfer to Minors Act as lessor, and “Clear Vision Eye Center, Inc.”, as lessee. *See*, Taxpayer Ex. No. 6. Check nos. 2498, 2406, 2219.
13. “Dr. Daniel DeFoe” purchased the equipment that was the subject of Equipment Lease Agreement No. 36A between “John Doe”, as Custodian for “Antoine DeFoe” Under the Illinois Uniform Transfer to Minors Act as Lessor and “Clear Vision Eye Center, Inc.”, as lessee. *See*, Taxpayer Ex. No. 7. Check nos. 2499, 2407, 2485, 2390, 2216, 2306, 2342, 2303, 2392, 2090, 2343, 2340.
14. “Dr. DeFoe” was not registered as a retailer during the audit period. Tr. p. 42.
15. “Dr. DeFoe” did not produce any resale certificates for the purchase of the equipment at issue. Tr. p. 42.
16. Neither the taxpayer nor any other individual or entity paid use tax on the equipment purchases. Tr. p. 43.

Conclusions of Law:

The Department prepared corrected returns for Use Tax liability pursuant to section 4 of the Retailers' Occupation Tax (hereinafter ROT) Act. 35 ILCS 120/4. Said section is incorporated by reference in the Use Tax Act via section 12 thereof. 35 ILCS 105/12. In its brief, the Department contends that the taxpayer protested the Notice of Tax Liability ("NTL") issued for the period beginning 7/1/90 through 11/30/93, but failed to protest the NTL for the subsequent period of 12/1/93 through 12/31/95. The Department offered both NTLs into evidence, however, it did not raise this issue at hearing, nor was it listed in the pre-hearing order. The result of which is that the taxpayer was not apprised of this issue and was not afforded the opportunity to offer probative evidence. Accordingly, it is my determination that Administrative Hearings has jurisdiction over the entire audit period of 7/1/90 through 12/31/95 and this recommendation for disposition will address the entire period. Further, my recommendation for disposition will only examine the issues analyzed in the taxpayer's post-hearing brief which, it should be noted, failed to encompass all of the issues in the pre-hearing order.

In the case at bar, the taxpayer challenges the Department's assessment of Use Tax, penalty and interest on the purchase of equipment. Initially, taxpayer contends that the Department has assessed Use tax against the wrong entity while the Department argues that the evidence of record proves that "Dr DeFoe" purchased the leased equipment for use in Illinois and subsequently transferred it to various trusts. It maintains that these subsequent transfers of title do not discharge the taxpayer of his obligations under the Use Tax Act. Taxpayer then argues that even assuming *arguendo* that the taxpayer was the initial purchaser, he is not subject to Use tax and proposed two alternative theories to support his position. First, he argues that the taxpayer purchased

the equipment as an agent for the trust lessors. Alternatively, the taxpayer purchased the equipment but, thereafter, gave it to the various trusts as gifts, either way, alleviating his responsibility for Use tax on the purchase of this equipment. Taxpayer Brief p. 4.

Section 3 of the Use Tax Act provides, in pertinent part, that the tax is “imposed upon the privilege of using in this State tangible personal property purchased at retail from a retailer,” 35 **ILCS** 105/3. “Use” is defined as “the exercise by any person of any right or power over tangible personal property incident to the ownership of that property... .” 35 **ILCS** 105/2. The purchaser incurs the primary liability for payment of the tax (Klein Town Builders v. Department of Revenue, 36 Ill.2d 301 (1966)) and it is imposed regardless of whether the property is purchased in Illinois or elsewhere. Turner v. Wright, 11 Ill.2d 161 (1957).

The equipment at issue was the subject of various leases and the taxpayer maintains that he should not be assessed Use Tax since he was not the lessor of the equipment at issue. He provided various lease agreements between “John Doe”, the Custodian, for various members of the “DeFoe” family under the Illinois Uniform Transfers to Minors Act as lessor, and “Clear Vision Eye Center, Inc.” as lessee, to support his contention. Taxpayer is correct in his assertion that Illinois courts have determined that Use tax is properly imposed upon the lessor, who exercises the powers or rights incident to ownership by the act of leasing the equipment rather than the lessee, who merely had the right to physical possession of this leased equipment and whatever use rights bestowed by the lessor. Philco Corp. v. Department of Revenue, 40 Ill. 2d 312 (1968); Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976) and Continental Illinois Leasing Corp. v. Department of Revenue, 108 Ill. App. 3d 583 (1st Dist. 1982). However, the fact that the taxpayer was not the lessor under the lease agreements

provided is not determinative in the case at hand since attached to four of the lease agreements are copies of checks drawn by “John Doe”, the trusts’ custodian, all paid to the order of “Dr. Daniel DeFoe”, the taxpayer, as payee. All checks note that they are for the purchase of equipment. *See*, Taxpayer’s Ex. No. 1-4. These four exhibits also contain a cover letter from the trust custodian to “DeFoe” indicating that the checks represent “full payment for the equipment as agreed upon.” *Id.* Other leases contain copies of checks drawn by “DeFoe” and made out to various companies as the payee, each also noting that the check was for the purchase of equipment. *See*, Taxpayer’s Ex. No. 5-7. There is no evidence which would contradict the reasonable presumption attached to these checks: that the equipment was not purchased by the trusts directly, the taxpayer purchased the equipment and subsequently transferred it.

Secondly, taxpayer contends that he purchased equipment as an agent for the principal trusts. Although the purchase of equipment by an agent for a known principal does result in the imposition of tax on the principal, the evidence of record does not support his contention. 86 Ill. Admin. Code § 130.1915. Taxpayer did not provide any documentary evidence which proved that he was acting on behalf of the trusts, nor did he offer testimony by the alleged principal reflecting an intent to appoint the taxpayer as its agent. Merely arguing that he was acting as an agent on behalf of the trusts without evidence of such is insufficient to prevail against the Department’s *prima facie* case.

Lastly, the taxpayer contends that it gave the equipment to the trusts without consideration, therefore, he is not obligated to pay Use tax on the purchases of the equipment. This theory is not supported by Illinois law. Purchase of tangible personal property for another person’s use or consumption does not shift the Use tax liability to the donee. Section 1 of the ROTA provides:

‘[S]ale at retail’ shall be construed to include any transfer of the ownership of or title to tangible personal property to a purchaser, for use or consumption by any other person to whom such purchaser may transfer the tangible personal property without a valuable consideration, and to include any transfer, whether made for or without a valuable consideration, for resale in any form as tangible personal property unless made in compliance with Section 2c of this Act.

35 ILCS 120/1; *also see*, 86 Ill. Admin. Code §130.201(b).

Thus, the taxpayer purchased the equipment at retail and was obligated to remit Use tax to an Illinois retailer or self-assess Use Tax on purchases from out of state retailers. Merely gifting the equipment to another does not change the identity of the initial transaction.

Further, even if taxpayer sold the equipment to the trusts, he is liable for Use tax on his initial purchase since he did not comply with the provisions of Section 2c which provides in pertinent part that:

[F]ailure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller’s sales are sale for resale or that a particular sale is a sale for resale.

35 ILCS 120/2c (*emphasis added*).

Taxpayer was not registered as a retailer during the audit period nor did he offer any resale certificates or other probative evidence that he did not make these purchases at retail. Consequently, the sales of this equipment to the taxpayer are presumed to be sales at retail and as a result, Use tax is properly imposed upon the taxpayer.

Pursuant to Illinois statute and case law, the correction of returns is *prima facie* correct and constitutes *prima facie* evidence of the correctness of the tax due. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). The Department’s determinations are rebutted only after a taxpayer introduces documentary evidence which is consistent,

probable and identified with taxpayer's books and records, showing that the Department's determination is incorrect. A. R. Barnes v. Department of Revenue, 173 Ill. App. 3d 826, 835 (1st Dist. 1988). While the taxpayer argues that he has presented sufficient evidence to shift the burden of proof back to the Department, it is evident by the discussion above, that not only does the evidence of record clearly fail to support his position, it in fact upholds the correctness of the Department's determination of tax due as reflected on both Notices of Tax Liability. Thus, the taxpayer has failed to overcome the Department's *prima facie* case.

Wherefore, it is my recommendation that the Notices of Tax Liability be finalized.

Enter:

Date: April 8, 1999

Christine O'Donoghue
Administrative Law Judge